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No. 144

In the Supreme Court of the United States

OCTOBER TERM, 1958

FORD MOTOR COMPANY, *Petitioner*,

v.

THE UNITED STATES.

On Petition for a Writ of Certiorari to the United States Court of Claims.

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

RESPONDENT'S BRIEF

The principal reason stated for granting the writ (Pet. p. 6) is:

> "1. The Court of Claims has decided an important question of federal law which has not been, but should be, settled by this Court for the guidance of manufacturers generally and for orderly administration of the Statute."

Factual analysis was set forth in support of this ground (Pet. pp. 6-7).

The Brief for the United States in Opposition, however, neither has made specific response to this ground nor answered the analysis.

A further reason urged for granting the writ (Pet. p. 15) was:

> "4. The decision below is erroneous and should be reviewed by this Court."

An analysis demonstrating the error in the decision below was set forth on pages 15-19 of the petition. The brief in opposition does not specifically answer this analysis. Instead, it enlarges, by restatement, the question presented and then purports to meet the enlarged question by an argument not pertinent to the narrow question presented here.

The questions presented in the petition are whether "cash payments or cash credits" made or allowed (1) pursuant to an express warranty, and (2) pursuant to a practice or policy of adjustment, in respect to defects, are price readjustments by "rebate or allowance" within the meaning of Section 3443(a)(2) of the Internal Revenue Code of 1939 and Section 6416(b)(1) of the Internal Revenue Code of 1954.

The brief of the United States in opposition, however, states a broader question (p. 2): Whether a manufacturer, "which incurred costs in fulfilling an express warranty", is entitled to a refund. So restated, the question is broad enough to include the factual situation in the *Frigidaire* case where the manufacturer merely incurred warranty costs in dealing with the *ultimate* purchaser. But the facts in this

case are, that the contract between the manufacturer and its immediate vendee is, by implication, reformed by a reduction in price to such vendee to reflect the value of the defective article.

The tax is on the manufacturer's price to its immediate vendee; the refund provision therefore relates only to allowances, rebates or adjustments made by the manufacturer to its immediate vendee. (Regulations 46, Sec. 316.13, Pet. p. 18.) Thus, it is the cash payment or cash credit by petitioner to its immediate vendee which is controlling. Hence the question presented is limited to "cash payments or cash credits" made by the petitioner to its immediate vendee.

As further grounds for granting the writ, petitioner also pointed out (Pet. p. 7) that "2. Confusion confronts manufacturers as a result of the four recent Court of Claims decisions".

The Brief in Opposition does not dispute the fact of inconsistency in the Court of Claims decisions, but merely asserts that "there is no inconsistency *relevant* to the present controversy" (emphasis supplied) (Br. p. 7).

This statement is incorrect in two respects.

First, the Government, in stating the basis for its position that inconsistencies in the *Frigidaire* decisions are not relevant here, overlooks a principal issue in the present case. The Government assumes that "What is involved here is nothing more than the *customary* manufacturer's *warranty* on automotive products," (emphasis supplied) (Br. p. 5). On this basis it contends that the *Frigidaire* cases contain no

relevant inconsistency since only a warranty broader in scope than customary was in issue in the first and second *Frigidaire* cases, and, while the third and fourth *Frigidaire* cases would permit recovery based on a warranty which is *not customary*, they held that a customary warranty will not support recovery.

Thus, even accepting the Government's view of relevancy, these cases are clearly relevant since a principal question in this case is whether petitioner's *policy*, which is entirely separate from and broader than the express warranty, is grounds for recovery.

Second, as pointed out on pages 10 and 11 of the petition, the first two *Frigidaire* cases proceeded on the legal premise that costs of fulfilling a warranty amounted to readjustments of price by means of an allowance within the refund provisions of the statutes—a position which, if it had not been reversed by the third *Frigidaire* case (Pet. p. 11) would have resulted in a decision below in favor of petitioner.

Nevertheless, reply also will be made to the specific arguments made in the Brief of the United States in Opposition.

ARGUMENT

The argument for the United States in opposition to the Petition for Certiorari is based on two assumptions (Br. p. 4): (1) "The issue presented by the decision below has received consideration only by the Court of Claims, and no conflict with a decision of any other court is or can be asserted"; and (2) "Prior decisions of the Court of Claims which taxpayer contends are inconsistent with the decision below involved a different issue which is not presented by this case".

1. The decision below, although not in conflict with any decision of another court involving the refund provision, is nevertheless in conflict with the well established common law and Uniform Sales Act concept that a readjustment of "price" results upon rebate or allowance to an immediate vendee on account of defects.

The decision below (156 F. Supp. 554, App. B to the Petition)—as the brief in opposition points out—adhered to the "same view" expressed in the third *Frigidaire* case (147 F. Supp. 739) (Br. p. 5):

> "The sales price was for an article free of defects. The cost of remedying defects that later appeared, therefore, cannot be an 'allowance' to the purchaser to be deducted from the sales price. It was not an 'allowance', but a sum spent to give to the purchaser what the manufacturer had represented it was selling him, to wit, a sound article."

On the facts there involved, the foregoing may be taken as holding, in effect, that the costs incurred by a manufacturer in a transaction with an *ultimate* purchaser cannot, as a matter of law, be deemed to be a readjustment of the price at which the manufacturer made its sale to its immediate vendee.

The decision below is both unsound and in direct conflict with the law governing sales when it is applied to the cash payments or cash credits made by the petitioner to its immediate vendees by reason of defects covered by the petitioner's warranty or policy.

Starting with the premise that the original contract "price" was for an article free of defects, the early common law developed the principle that an allowance to the immediate vendee on account of such vendee's cost of remedying a defect is, as a matter of law, a dim-

inution of the sales price by a readjustment to the value of the defective article sold. This concept was adopted in section 69(1)(a) of the Uniform Sales Act which provides that where there is a breach of warranty by the seller, the buyer may at his election "Accept or keep the goods and set up against the seller, the breach of warranty by way of recoupment or diminution or extinction of the price".

As explained in 3 Williston on Sales (Rev. Ed.) § 605, the recoupment concept involved in the Sales Act is not that of a technical set-off or counterclaim for damages. On the contrary, the theory of recoupment, in diminution of the purchase price, is that a defendant-vendee who has accepted and retained the defective article is "allowed to avoid the contract which was made and substitute in its stead a *quasi*-contractual obligation for the value of what he has received". Thus the transaction is deemed to have been changed by mutual consent from an express contract to purchase an article free from defect at the stated price to an implied contract to purchase a defective article at an adjusted price.* In section 605-a, Williston traced this concept of price readjustment back to *Mondel* v. *Steel*, 8 M.&W. 858 (1841), where the court pointed out:

> "* * * for in these cases the acceptance or non-return affords evidence of a new contract on a *quantum valebat*. * * *
>
> "* * * the rule which has been found so convenient is established: and that it is competent for the defendant, in all of those, not to set off, by a proceeding in the nature of a cross-action, the

* See in this connection, analysis on pages 15-19 of the Petition.

> amount of damages which he has sustained by breach of the contract, but simply to defend himself by showing how much less the subject-matter of the action was *worth*, by reason of the breach of contract; and to the extent he obtains * * * an *abatement of price* on that account, he must be considered as having received satisfaction for the breach of contract, and is precluded from recovery in another action to that extent * * *" (emphasis supplied)

Williston states (§ 605-a) that section 69(1)(a) of the Uniform Sales Act (of which he was the author) was "clearly intended to enact that recoupment in the narrow sense defined above is a permissible remedy for breach of warranty". Thus, when a seller sues for the purchase price of a warranted article, the stated price is deemed in law to have been reduced by abatement or allowance in an amount equal to that required to remedy or compensate for the defect in the article sold*.

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* See, e.g., such cases as:

Dushare v. Benedict, 120 U.S. 630, 643 (1887) (abatement)

Continental Jewelry Co. v. Pugh Bros., 168 Ala. 295, 53 So. 324, 326 (1910) (abatement)

Fletcher v. Ozark Packing Co., 188 F. 2d 858, 860 (8th Cir., 1951) (applying Ark. law) (recoupment or extinction)

Arcady Farms Milling Co. v. Eagle Poultry Packers, Inc., 45 Del. 389, 73 A. 2d 220 (1950) (diminution)

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Kelly v. Emary, 242 Iowa 683, 45 N.W. 2d 866, 869-70 (1951) (diminution or extinction)

J. B. Beaird Co. v. Burris Bros., Ltd., 216 La. 655, 44 So. 2d 693, 697 (1949) (reduction)

If a manufacturer, having sold on credit, were to sue for the purchase price and procure a judgment against the buyer limited to the price so diminished by recoupment to the value of the defective article sold, there could be no doubt that the manufacturer would be entitled to a refund *pro tanto* in respect of his payment of excise tax on the basis of the full contract price.

It is submitted that there should be no difference in the application of the refund provision of the statute where the readjustment to the immediate vendee has been by cash payments or cash credits pursuant to the provisions of an express warranty or policy rather than by way of recoupment in an action by the vendor for the price.

It must be presumed that the Congress, in referring to a readjustment in "price", by "rebate or allowance" in the refund provisions of the statutes, must have intended to embrace the concept of price readjustment attendant upon retention of the defective article as developed at common law and as incorporated into the Uniform Sales Act.

The interpretation by the Court of Claims of the refund sections of the statutes in a manner apparently in conflict with the basic common law concepts carried over into the Uniform Sales Act, and the court de-

Morse v. Moore, 83 Me. 473, 22 Atl. 362 (1891) (reviewing 19th century authorities)

Morrow v. Barrow Motor Co., 90 So. 2d 20, 22-23 (1956) (reduction)

Hever v. Ulmer, 281 S.W. 2d 320, 324 (1955) (recovery for real value only)

Hunter v. Finnerty, 119 Misc. 724, 197 N.Y. Supp. 215 (Ap. Term, 1st Dept. 1922)

cisions thereunder, presents a question of general importance which should be reviewed by this Court on certiorari.

2. The fourth *Frigidaire* decision highlights inconsistencies of critical importance in the present case.

The fourth *Frigidaire* case (App. B, Brief in Opposition) decided subsequent to the filing of the petition herein, throws into sharp relief the inconsistent positions largely apparent in the earlier Frigidaire opinions—taken by four judges of the Court of Claims concerning the nature and significance of customary and non-customary warranties.

The third *Frigidaire* decision had held that the five-year warranty would support recovery because it was broader in scope than the customary warranty. In the fourth *Frigidaire* decision, where it had been found as a fact that the five-year warranty was *customary* in the trade, a majority held against recovery. The positions taken by Judges Jones, Laramore, Whitaker and Madden in these two cases may be summarized as follows:*

(a) *Judges Jones and Laramore*: A warranty is "customary" if it is customary in the trade, and, *if* "*customary*", will not support recovery.

(b) *Judge Whitaker*: A warranty is customary if co-extensive with a manufacturer's obligation to sell a sound article. His opinions in the first and third *Frigidaire* cases clearly indicate that he views the scope and duration of such obligation as roughly equivalent to the scope and duration of a warranty which would be implied by law. He believes that a warranty which is broader in

* The position of Judge Littleton does not appear with reasonable certainty.

scope than this obligation of the manufacturer will support recovery *even if such warranty were customary in the trade.*

(c) *Judge Madden*: It is immaterial whether a warranty is customary or not; neither will support recovery.

When the Government, in essence, argues that inconsistencies in the *Frigidaire* cases concerning non-customary warranties are irrelevant because "what is involved here is nothing more than the *customary* manufacturer's warranty on automotive products" (emphasis supplied) (Br. p. 5), it fails to meet the second question presented in this petition.

The second question presented (Pet. p. 2) does not involve the express warranty, but solely concerns petitioners policy, which is applicable to periods both within and beyond the "90 day or 4000 miles" period provided in petitioner's express warranty (Pet. Ct. Cl. p. 2).

A principal issue presented by this second question under the *Frigidaire* cases is whether petitioner's policy is a non-customary warranty entitling it to recovery.

The Government admits that

> "* * * a particular arrangement warranting an article for an extended period may, on particular facts, justify an exclusion from the purchase price, for what is in form a warranty of fitness may be in substance an agreement to give special service or maintenance." (Br. p. 9)

But the inconsistent positions of the judges of the Court of Claims concerning customary and non-cus-

tomary warranties, as outlined above, render most uncertain the "particular facts" on which recovery may be achieved. The confusion which confronts manufacturers in endeavoring to arrange their programs for handling possible defects in their products in order to come within the Court of Claims decisions may be illustrated with respect to petitioner's policy.

Thus, if petitioner's policy were found as a fact to be:

(a) not customary in the industry and broader in scope than the warranty implied by law, Judges Jones, Laramore and Whitaker would favor recovery while Judge Madden would not;

(b) not customary in the industry but similar in scope to a warranty implied in law, Judges Madden and Whitaker would be against recovery while Judges Jones and Laramore would favor it;

(c) customary in the industry but broader in scope than a warranty implied by law, Judge Jones, Laramore and Madden would be against recovery while Judge Whitaker would favor it (fourth *Frigidaire* case);

(d) customary in the industry and similar in scope to a warranty which would be implied by law, Judges Jones, Laramore, Whitaker and Madden would be against recovery.

But in this case (which was decided prior to the fourth *Frigidaire* case), Judge Whitaker, writing for the court, did not apply either of the foregoing tests of "customary" to plaintiff's warranty policy.

In the *Ford* case, Judge Whitaker concluded that petitioner's express warranty was customary, presum-

ably both because similar in scope to an implied warranty and customary in the industry. This conclusion was apparently based on judicial notice since no evidence on the subject of "customary" was before the Court.

Judge Whitaker then concluded that petitioner's policy was merely in liberal interpretation of its express warranty. This was apparently based on the allegation in the petition before the Court of Claims that the scope of its policy included "periods both within and beyond the periods" covered by the express warranty. While it was competent for petitioner under this allegation to prove that its policy was not "customary" and was far broader in scope than its express warranty, this possibility was never even considered by the Court in its disposition of this case by its judgment on the pleadings.

Clearly, plaintiff is entitled at minimum to a determination of whether or not its policy is "customary" in view of the majority opinion of the Court of Claims in the *Frigidaire* cases that a warranty beyond that which is customary may provide a basis for recovery*.

But before such a determination may properly be made, there must be an authoritative decision by this Court of (1) whether there should be any distinction in legal effect between "customary" and "extraordi-

* Essential to such determination is an opportunity for plaintiff to prove as a fact that its policy is not "customary". Just as Frigidaire was accorded an opportunity to prove that its five-year warranty was not "customary", so also petitioner must be accorded such opportunity. No facts necessary for application of either test of "customary" were before the Court of Claims in the present case.

nary" warranties, and if so, (2) the correct test of what constitutes "customary".

CONCLUSION

It is respectfully submitted that this writ should be granted on the grounds that the Court of Claims has (1) made an erroneous ruling on an important general question of federal law which has not been, but should be, settled by this Court; and (2) has made conflicting decisions on issues presented here which should be reviewed by the Court for the guidance of manufacturers generally and for orderly administration of the statute.

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